# QUARTERLY REPORT
**FOR THE PERIOD ENDED**
**June 30, 2014**

## PARAGON TECHNOLOGIES, INC.

101 Larry Holmes Drive, Suite 500
Easton, PA 18042
Telephone: 610-252-3205
Fax: 610-252-3102

| I.R.S. Employer Identification No. | CUSIP No. |
|---|---|
| 22-1643428 | 69912T108 |

**ISSUER'S EQUITY SECURITIES**

**COMMON STOCK**

**$1.00 Par Value**

**20,000,000 Common Shares Authorized**

**1,684,745 Shares Issued and Outstanding**
**as of the Filing of this Quarterly Report**

**1) Name of the Issuer and its predecessors (if any):**

The name of the issuer is Paragon Technologies, Inc. The issuer was formerly known as SI Handling Systems, Inc. until April 5, 2000.

**2) Address of the Issuer's principal executive offices:**

Company Headquarters
Paragon Technologies, Inc.
101 Larry Holmes Drive, Suite 500
Easton, PA 18042
Phone: (610) 252-3205
E-Mail: info@pgntgroup.com
Website(s): www.pgntgroup.com

IR Contact
Paragon Technologies, Inc.
101 Larry Holmes Drive, Suite 500
Easton, PA 18042
Phone: (706) 549-7141
E-Mail: ir@pgntgroup.com
Website(s): www.pgntgroup.com

**3) Security Information:**

Trading Symbol: PGNT
Exact title and class of securities outstanding: Common Stock
CUSIP: 69912T108
Par Value: $1.00 per share
Total shares authorized: 20,000,000
Total shares outstanding: 1,684,745

Transfer Agent
American Stock Transfer & Trust Company
6201 15th Avenue
Brooklyn, NY 11219
Phone: (718) 921-8206
Is the Transfer Agent registered under the Exchange Act: Yes: ☑ No: ☐

List any restrictions on the transfer of security:
None

Describe any trading suspension orders issued by the SEC in the past 12 months:
None

**4) Issuance History:**

**List below any events, in chronological order, that resulted in changes in total shares outstanding by the issuer in the past two fiscal years and any interim period. The list shall include all offerings of securities, whether private or public, and all shares or any other securities or options to acquire such securities issued for services, describing (1) the securities, (2) the persons or entities to whom such securities were issued, and (3) the services provided by such persons or entities. The list shall indicate:**

A. The nature of each offering (e.g., Securities Act Rule 504, intrastate, etc.);
Private placement under Rule 506 of the Securities Act of 1933 on September 4, 2012.

B. Any jurisdictions where the offering was registered or qualified;
Not Applicable.

C. The number of shares offered;
81,000 Shares.

D. The number of shares sold;
81,000 Shares.

E. The price at which the shares were offered, and the amount actually paid to the issuer;
The shares were sold at $2.50 per share and were fully paid in cash.

F. The trading status of the shares; and
The shares were issued as restricted stock under the Securities Act of 1933.

G. Whether the certificates or other documents that evidence the shares contain a legend (1) stating that the shares have not been registered under the Securities Act, and (2) setting forth or referring to the restrictions on transferability and sale of the shares under the Securities Act.
Yes. These legends were removed after the expiration of one year from the date the shares were purchased.

With respect to private offerings of securities, the list shall also indicate the identity of the persons who purchased securities in such private offering; *provided*, *however*, that in the event that any such person is an entity, the list shall also indicate (a) the identity of each natural person beneficially owning, directly or indirectly, more than ten percent (10%) of any class of equity securities of such entity and (b) to the extent not otherwise disclosed, the identity of each natural person who controlled or directed, directly or indirectly, the purchase of such securities for such entity.

| Name | Shares |
|---|---|
| Derek Bork | 5,000 |
| Shaun E. Hayes | 76,000 |

**5) Financial Statements:**

The financial statements for the six months ended June 30, 2014 are incorporated by reference and can be found at the end of this Quarterly Report. The financial statements as of and for the period ended June 30, 2014 include: (1) consolidated balance sheets, (2) consolidated statements of operations, (3) consolidated statements of comprehensive income (loss), (4) consolidated statements of cash flows, (5) consolidated statements of stockholders' equity, and (6) notes to consolidated financial statements.

## 6) Describe the Issuer's Business, Products, and Services:

**Describe the issuer's business so a potential investor can clearly understand the company. In answering this item, please include the following:**

### A. Description of the issuer's business operations:

**Business**

Paragon Technologies, Inc. ("Paragon" or the "Company"), based out of Easton, Pennsylvania, provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications through its wholly owned subsidiary, SI Systems, LLC ("SI Systems"). SI Systems' capabilities include horizontal transportation, rapid dispensing, order fulfillment, Warehouse Management Systems (WMS), Warehouse Control Systems (WCS), branded as a WES (warehouse execution system) and aftermarket services.

SI Systems' automated material handling systems are used by manufacturing, assembly, order fulfillment, and distribution operations customers located primarily in North America, including the U.S. government. SI Systems' branded products are utilized to automate the movement or selection of products and are often integrated with other automated equipment such as conveyors and robots. SI Systems is brought to market as two individual brands, SI Systems' Order Fulfillment Systems (hereafter referred to as "SI Systems OFS") and SI Systems' Production & Assembly Systems (hereafter referred to as "SI Systems PAS").

The OFS business focuses on providing order fulfillment systems to distribution operations, including DISPEN-SI-MATIC®, Mobile-matic® (a patented product) and Warehouse Management Systems and Warehouse Control Systems software solutions with our VWare™ WES product. These systems are sold primarily through a nationwide network of authorized material handling integrators, dealers and direct to major OEM accounts.

The PAS business focuses on providing automated material handling systems to manufacturing and assembly operations via LO-TOW® horizontal transportation technologies. These systems are sold primarily to end users.

SI Systems' automated material handling systems are marketed, designed, sold, installed, and serviced by its own staff or subcontractors as labor-saving devices to improve productivity, quality, and reduce costs. SI Systems' integrated material handling solutions involve both standard and specially designed components and include integration of non-proprietary automated handling technologies to provide turnkey solutions for its customers' unique material handling needs. SI Systems' engineering staff develops and designs computer control programs required for the efficient operation of the systems and for optimizing manufacturing, assembly, and fulfillment operations.

SI Systems' business is largely dependent upon a limited number of large contracts with a limited number of customers. This dependence can cause unexpected fluctuations in sales volume. Various external factors affect the customers' decision-making process on expanding or upgrading their current production or distribution sites. Customer's timing and placement of new orders is often affected by factors such as the current economy, current interest rates, and future expectations. SI Systems believes that its business is not subject to seasonality, although the rate of new orders can vary substantially from month to month. Since the Company recognizes sales on a percentage of completion basis for its systems contracts, fluctuations in SI Systems' sales and earnings occur with increases or decreases in major installations.

Paragon also invests in businesses and securities under the Investment Management Policy. The Investment Management Policy sets forth the parameters under which a portion of Paragon's cash balance may be invested in marketable securities, including U.S. Treasuries, equities of publicly traded companies, bonds, money market instruments and other securities. Investment decisions under the Investment Management Policy are made by Hesham Gad, Chairman and Chief Executive Officer. The Investment Management Policy sets forth restrictions on the investment of Paragon's funds, including an aggregate limit on Paragon's cash balance that is made available for investment, limits on the amount that may be invested in any single equity or fixed income position or certain categories of securities, prohibition of short-selling, margin trading and the use of leverage without Board approval, requirements for the management of the investment account, and other Board-approval requirements.

**B. Date and State (or Jurisdiction) of Incorporation:**

The Company was originally incorporated in Pennsylvania on June 18, 1958 as SI Handling Systems, Inc.

On April 5, 2000, SI Handling Systems, Inc. changed its name to Paragon Technologies, Inc.

The Company changed its state of incorporation from Pennsylvania to Delaware on November 21, 2001.

**C. The issuer's primary and secondary SIC Codes:**

| | |
|---|---|
| Primary SIC Code: | 3530 |
| Secondary SIC Code: | N/A |

**D. The issuer's fiscal year end date:**

The Company's fiscal year end is December 31.

**E. Principal products or services, and their markets:**

**<u>SI Systems' Branded Products</u>**

SI Systems' branded products encompass the horizontal transport and order fulfillment families of products.

**<u>Horizontal Transport</u>**

**<u>LO-TOW</u>**®. LO-TOW® is an in-floor towline conveyor. These conveyor systems are utilized in the automation of manufacturing, assembly and unit load handling in distribution environments. Industries served include the automotive, recreational and utility vehicle, distribution centers, radiation chambers, engine assembly, truck assembly, construction vehicles, newspaper facilities, farm machinery, and the U.S. government, primarily the United States Postal Service and the Defense Logistics Agency. This simple, yet reliable component design allows for a variety of configurations well suited for numerous applications. It provides reliable and efficient transportation for unit loads of all types in progressive assembly or distribution applications. Because SI Systems' LO-TOW® tow chain used with the system operates at a minimal depth, systems can be installed in existing one-story and multi-story buildings as well as newly constructed facilities. Controls sophistication varies depending upon the application. More complex systems include programmable logic controllers ("PLCs"), personal computers for data collection and operator interface, radio frequency identification and communication, bar code identification, and customer host computer communication interface. The Company believes that SI Systems is the largest supplier of in-floor towline systems in the United States. A typical LO-TOW® system requires anywhere from 4 to 6 months to engineer, manufacture, and install depending on complexity.

## Order Fulfillment Systems

### DISPEN-SI-MATIC®, Mobile-matic®, VWare™

DISPEN-SI-MATIC® and VWare™ offer ideal solutions for reducing inefficiencies, labor-intensive methods, and long-time deliveries where high a volume of orders must be fulfilled. Industries served include pharmaceutical, entertainment, vision, nutritional supplements, health and beauty aids, cosmetics, and an assortment of various accessories such as jewelry.

SI Systems' branded products include a variety of DISPEN-SI-MATIC® models for automated order fulfillment, where volume, speed, accuracy, and efficiency are of the essence. The Pick-to-Belt, Pick-to-Tote and Pick-to-Bucket are solutions that provide ultra-high throughput for loose-pick fulfillment. Additionally, the DISPEN-SI-MATIC® monitors the dispensing of packages into totes or cartons thus achieving a high degree of accuracy and efficiency in order fulfillment.

**Mobile-matic**® was introduced to the market in the fourth quarter of 2010 to target a wider base of potential customers. **Mobile-matic®,** a mobile version of the DISPEN-SI-MATIC® with fewer channels is scalable and also automatically dispenses product directly into cartons or totes being transported on an adjacent conveyor or directly onto an adjacent conveyor to feed downstream operations.

Our Versatile Warehouse™ (**VWare**™) family of products is founded on industry standard Microsoft technologies. The modular architecture utilizes the latest object-oriented design techniques and methodologies to ensure the best possible reliability and maintainability. Our scalable product line deploys on a Windows based system utilizing client-server technology capable of enterprise-level inventory control and order fulfillment applications. We have designed our runtime environment around the most popular platform utilized today for scalable information systems. Microsoft Windows workstations utilize Open Database Connectivity (ODBC) to interact with a Microsoft SQL Server database. The baseline system is hosted on a Windows server. The Versatile Warehouse™ family of warehouse control applications work in concert on client workstations to collectively form a scalable distributed processing system capable of managing a wide variety of concurrent tasks. Selective tasks have been designed to take advantage of Microsoft Windows native connectivity capabilities to import order fulfillment and warehouse maintenance demands, while exporting work request status to external systems.

A typical DISPEN-SI-MATIC®, **VWare**™, solution system requires approximately six months to engineer, manufacture, and install.

### Aftermarket Spare Parts, Equipment and Support Service

SI Systems provides spare and replacement parts and equipment for all of its products, along with support contract services for its order fulfillment systems.

## 7) Describe the Issuer's Facilities:

Paragon Technologies, Inc.
101 Larry Holmes Drive, Suite 500
Easton, PA 18042

The Company leased 25,000 square feet in Easton, Pennsylvania for use as its principal office. The leasing agreement required fixed monthly rental payments of $18,000. The terms of the lease also required the payment of a proportionate share of the facility's operating expenses. The leasing agreement was secured with a $200,000 letter of credit. The lease expired on February 20, 2013.

On November 28, 2012, the Company renewed the lease agreement to extend the term of the lease for a period of one year. Commencing on February 21, 2013, the square footage of the lease was reduced to 15,200 square feet. The renewed lease agreement required fixed monthly rental payments of $12,750 for one year through February 20, 2014. The terms of the lease no longer required the payment of a proportionate share of the facility's operating expenses.

On December 30, 2013, the Company entered into a new lease agreement for an initial term of two years, followed by an option to renew for two consecutive/additional terms of two years each. The lease commenced on April 15, 2014. Based on prior agreement with the new lessor, the Company started occupying the new space effective February 17, 2014. The area of the new lease is 9,648 square feet in Easton, Pennsylvania. The leasing agreement requires fixed monthly payments of $12,750. The new address/location of the premises is as follows:

Paragon Technologies, Inc.
101 Larry Holmes Drive, Suite 500
Easton, PA 18042

The Company believes that its new Easton, Pennsylvania facility is adequate for its current operations. The Company's operations experience fluctuations in workload due to the timing and receipt of new orders and customer job completion requirements. Currently, the Company's facility is adequate to handle these fluctuations. In the event of an unusual demand in workload, the Company supplements its internal operations with outside subcontractors that perform services for the Company in order to complete contractual requirements for its customers. The Company will continue to utilize internal personnel and its own facility and, when necessary and/or cost effective, outside subcontractors to complete contracts in a timely fashion in order to address the needs of its customers.

## 8) Officers, Directors, and Control Persons:

### A. Names of Officers, Directors, and Control Persons.

Information concerning The Company's directors is as follows:

| Name, Other Positions or Offices With the Company and Principal Occupation for Past Five Years | Director Since | Age |
|---|---|---|
| Hesham M. Gad........................................................................................................ | 2010 | 36 |
| Hesham M. Gad has been Chief Executive Officer of the Company since June 2014, Chairman of the Company's Board of Directors since March 2012 and a director of the Company since October 2010. Mr. Gad is also the Chairman and -CEO of SED International Holdings, Inc. (OTC: SEDN). Paragon is the largest shareholder in SED. Mr. Gad is the founder and managing partner of Gad Partners Fund, a value oriented investment partnership launched in 2007, modeled after the 1950's Buffett Partnerships and based in Athens, GA. Mr. Gad has over 13 years of investment and business management experience. From 2006 to 2007, while earning his MBA, Mr. Gad worked as a freelance securities analyst for UAS Asset Management, a boutique value investment firm in New York City.<br><br>Mr. Gad is also the author of the internationally published book, "The Business of Value Investing." Mr. Gad holds a B.A. in finance and an MBA in finance from the University of Georgia. | | |
| Jack H. Jacobs ........................................................................................................ | 2012 | 68 |
| Jack H. Jacobs has been a principal of The Fitzroy Group, Ltd., a firm that specializes in the development of residential real estate in London and invests both for its own account and in joint ventures with other institutions, for the past six years. He has held the McDermott Chair of Politics at West Point since 2005 and has served as an NBC military analyst since 2002. Mr. Jacobs was a co-founder and Chief Operating Officer of AutoFinance Group Inc., one of the firms to pioneer the securitization of debt instruments, from 1988 to 1989; the firm was subsequently sold to KeyBank. He was a Managing Director of Bankers Trust Corporation, a diversified financial institution and investment bank, where he ran foreign exchange options worldwide and was a partner in the institutional hedge fund business.<br><br>Mr. Jacobs' military career included two tours of duty in Vietnam where he was among the most highly decorated soldiers, earning three Bronze Stars, two Silver Stars and the Medal of Honor, the nation's highest combat decoration. He retired from active military duty as a Colonel in 1987. From 2007 to 2012, Mr. Jacobs served as a member of the Board of Directors of Xedar Corporation, a public company; from June 2006 to 2009, he was a director of Visual Management Systems, a private company; he was a director of BioNeutral Group, Inc., a public company, until 2009; and from 2009 to 2012, he was a director of Premier Exhibitions, Inc. (Nasdaq: PRXI), a public company. Mr. Jacobs is Vice Chairman of the Medal of Honor Foundation and a member of the Board of Trustees of the USO of New York. Mr. Jacobs is the author of the book "If Not Now, When?: Duty and Sacrifice in America's Time of Need." Mr. Jacobs received a Bachelor of Arts and a Master's degree from Rutgers University. | | |

| Name, Other Positions or Offices With the Company and Principal Occupation for Past Five Years | Director Since | Age |
|---|---|---|
| Samuel S. Weiser | 2012 | 54 |

Samuel S. Weiser is currently and since August 2009 has been a member of the Board of Directors of Premier Exhibitions, Inc. (Nasdaq: PRXI), a provider of museum quality touring exhibitions. In addition, Mr. Weiser served as President and Chief Executive Officer of Premier Exhibitions from November 2011 until June 2014. Mr. Weiser also became a member of SED International's Board of Directors in October of 2013. Previously, Mr. Weiser served as a member and Chief Operating Officer of Sellers Capital LLC, an investment management firm, from 2007 to 2010 and remains a member of the firm. From 2005 to 2007, he was a Managing Director responsible for the Hedge Fund Consulting Group within Citigroup Inc.'s Global Prime Brokerage Division. From 2002 to April 2005, he was the President and Chief Executive Officer of Foxdale Management, LLC, a consulting firm founded by Mr. Weiser that provided operational consulting to hedge funds and litigation support services in hedge fund related securities disputes. Mr. Weiser also served as Chairman of the Managed Funds Association, a lobbying organization for the hedge fund industry, from 2001 to 2003 and was formerly a partner in Ernst and Young. He received his B.A. in Economics from Colby College and a M.A. in Accounting from George Washington University.

The directors of the Company hold their positions as directors until the next Annual Meeting of Stockholders.

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The names, ages, and offices with the Company of its executive officers are as follows:

| Name | Age | Office |
|---|---|---|
| Hesham Gad | 36 | Chief Executive Officer, Paragon Technologies |
| Deborah Mertz | 57 | Chief Financial Officer, Paragon Technologies/ SI Systems, LLC. |
| John C. Molloy | 62 | President and Chief Executive Officer, SI Systems, LLC. |

**John C. Molloy** has over 30 years of financial and executive management experience, including acquisitions, divestitures, reorganizations, strategic planning software systems and change management. From 2010 to 2014, John was the Founder and CEO of Sapient Automation, an established material handling company that focuses on carousel and vertical lift market applications. From 2002 to 2009 Mr. Molloy was White Systems' President/ COO and CFO from 1997 to 2002. In 2005, he led a management buyout of White Systems from F.K.I. (the second largest material handling company worldwide) along with a private equity group and from 2005 to 2009, Mr. Molloy was part owner of White Systems. From 1991 to 1996, Mr. Molloy served as VP/Corporate Controller of Lab-Volt Systems, Inc., a global leader in the design and manufacture of hands-on training laboratories for public education, industry and the military. John is a graduate of Fairleigh Dickinson University with a B.S. in Accounting. He also completed graduate work at Fordham University with a concentration in Finance and a three month Executive Management program at Stanford University.

**Deborah Mertz**, is an accounting professional with over 30 years experience in both publicly held and privately held companies. From 2006 to 2013 Ms. Mertz held the position of Assistant Controller of ASSA ABLOY Inc. Americas Division. ASSA ABLOY is the largest global supplier of intelligent lock and security solutions. From 1999 to 2006 Ms. Mertz was the Controller/CFO of Sargent Manufacturing Company. Sargent Manufacturing Company is a wholly owned subsidiary of ASSA ABLOY Inc. and manufactures architectural hardware used primarily in commercial construction. Ms. Mertz has held various other senior accounting positions. Ms. Mertz is a CPA and has an MBA from Rider University and a B.S. in Accounting from King's College.

**B. Legal/Disciplinary History. Please identify whether any of the foregoing persons have, in the last five years, been the subject of:**

1. A conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses).

   Except as set forth below, the executive officers and directors of the Company have not, in the last five years, been the subject of a conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses).

   On June 9, 2011, Mr. Gad was charged in the Superior Court of Athens-Clarke County, Georgia with making a false statement relating to the allegation that Mr. Gad checked the incorrect box on his driver's license application completed on March 27, 2007 as to whether Mr. Gad is a U.S. citizen. On October 19, 2011, Mr. Gad pled not guilty to this charge. This charge is subject to an Order Permitting Pretrial Diversion, pursuant to which the charge will be dismissed upon Mr. Gad's successful completion of the requirements under a Pretrial Diversion Agreement in effect between April 1, 2014 and March 31, 2016.

2. The entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended, or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities.

   The executive officers and directors of the Company have not, in the last five years, been the subject of the entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities.

3. A finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated.

   The executive officers and directors of the Company have not, in the last five years, been the subject of a finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated.

4. The entry of an order by a self-regulatory organization that permanently or temporarily barred, suspended or otherwise limited such person's involvement in any type of business or securities activities.

   The executive officers and directors of the Company have not, in the last five years, been the subject of the entry of an order by a self-regulatory organization that permanently or temporarily barred, suspended or otherwise limited such person's involvement in any type of business or securities activities.

**C. <u>Beneficial Shareholders</u>. Provide a list of the name, address and shareholdings or the percentage of shares owned by all persons beneficially owning more than ten percent (10%) of any class of the issuer's equity securities. If any of the beneficial shareholders are corporate shareholders, provide the name and address of the person(s) owning or controlling such corporate shareholders and the resident agents of the corporate shareholders.**

**<u>Security Ownership of Certain Beneficial Owners and Management</u>**

To the best of the Company's knowledge, the following table sets forth certain information as of June 30, 2014 (unless otherwise noted) regarding the ownership of common stock by each person known by the Company to be the beneficial owner of more than ten percent (10%) of the outstanding common stock. Unless otherwise stated, the beneficial owners exercise sole voting and/or investment power over their shares.

| Title of Class | Name and Address of Beneficial Owner (1) | Amount and Nature of Beneficial Ownership | Right to Acquire Under Options Exercisable Within 60 Days | Percent of Class (2) |
|---|---|---|---|---|
| Common Stock, Par Value $1.00 Per Share | Hesham M. Gad (3) | 361,657 | - | 21.5% |

(1) The address for the stockholder listed on the table is c/o Paragon Technologies, Inc., 101 Larry Holmes Drive, Suite 500 Easton, Pennsylvania 18042.
(2) The percentage for each individual, entity or group is based on the aggregate number of shares outstanding as of 6/30/2014.
(3) Mr. Gad holds 34,352 shares directly and beneficially owns 361,657 shares held by Gad Capital.

## 9) Third Party Providers:

Please provide the name, address, telephone number, and e-mail address of each of the following outside providers that advise your company on matters relating to operations, business development, and disclosure:

<u>Legal Counsel</u>:
Thompson Hine LLP
3900 Key Center
127 Public Square
Cleveland, Ohio 44114-1291
Telephone number: (216) 566-5500
E-mail address: Derek.Bork@thompsonhine.com

<u>Auditor</u>:
McGladrey LLP
751 Arbor Way, Suite 200
Blue Bell, PA 19422
Telephone number: (215) 641-8600
E-mail address: Susan.Roeder@mcgladrey.com

Investor Relations Consultant:
None.

Other Advisor:
None.

**10) Issuer Certification:**

The issuer shall include certifications by the chief executive officer and chief financial officer of the issuer (or any other persons with different titles, but having the same responsibilities).

I, Hesham Gad, President and Chief Executive Officer, certify that:

1. I have reviewed this quarterly disclosure statement of Paragon Technologies, Inc.;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations, and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

August 14, 2014

/s/ Hesham Gad
Hesham Gad
President and Chief Executive Officer

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The issuer shall include certifications by the chief executive officer and chief financial officer of the issuer (or any other persons with different titles, but having the same responsibilities).

I, Deborah R. Mertz, Chief Financial Officer, certify that:

1. I have reviewed this quarterly disclosure statement of Paragon Technologies, Inc.;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations, and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

August 14, 2014

/s/ Deborah R. Mertz
Deborah R. Mertz
Chief Financial Officer

**PARAGON TECHNOLOGIES, INC.**
**and Subsidiaries**

# QUARTERLY REPORT

## CONSOLIDATED FINANCIAL STATEMENTS — UNAUDITED
## FOR THE THREE MONTHS ENDED June 30, 2014

# CONSOLIDATED FINANCIAL STATEMENTS — UNAUDITED

## I N D E X

- **Consolidated Financial Statements:**

**PARAGON TECHNOLOGIES, INC.**
Consolidated Balance Sheets (Unaudited)
June 30, 2014 and December 31, 2013
*(In Thousands)*

| | June 30, 2014 | December 31, 2013 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 1,803 | $ 2,546 |
| Receivables: | | |
| Trade accounts | 970 | 700 |
| Income taxes receivable | 3 | - |
| Total receivables | 973 | 700 |
| Costs and estimated earnings in excess of billings | 250 | 199 |
| Inventories: | | |
| Raw materials | 136 | 67 |
| Work-in-process | 10 | 12 |
| Finished goods | 496 | 325 |
| Total inventories | 642 | 404 |
| Prepaid expenses and other current assets | 67 | 80 |
| Total current assets | 3,735 | 3,929 |
| Marketable securities | 493 | 325 |
| Equity method investment | - | - |
| Machinery and equipment, and software, at cost: | | |
| Machinery and equipment | 872 | 867 |
| Software | 755 | 534 |
| Less: accumulated depreciation | 1,146 | 1,130 |
| Net machinery and equipment | 481 | 271 |
| Other Assets- Intangible Assets, net | 836 | 882 |
| Total assets | $ 5,545 | $ 5,407 |

*See accompanying notes to consolidated financial statements.*

*(Continued)*

**PARAGON TECHNOLOGIES, INC.**
Consolidated Balance Sheets (Unaudited) *(Continued)*
June 30, 2014 and December 31, 2013
*(In Thousands)*

| | June 30, 2014 | December 31, 2013 |
|---|---|---|
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 1,059 | $ 642 |
| Billings in excess of costs and estimated earnings | 363 | 237 |
| Accrued salaries, wages, and commissions | 42 | 297 |
| Accrued product warranties | 143 | 159 |
| Unearned support contract revenue | 186 | 265 |
| Income taxes payable | 54 | 53 |
| Accrued other liabilities | 219 | 417 |
| Bank loan – line of credit | 200 | - |
| Total current liabilities | 2,266 | 2,070 |
| Other long-term liabilities | 105 | 105 |
| Total liabilities | 2,371 | 2,175 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock, $1 par value; authorized 20,000,000 shares; issued and outstanding 1,684,745 shares as of June 30, 2014 and 1,684,745 as of December 31, 2013 | 1,685 | 1,685 |
| Additional paid-in capital | 3,504 | 3,498 |
| Accumulated deficit | (2,068) | (1,969) |
| Accumulated other comprehensive income | 53 | 18 |
| Total stockholders' equity | 3,174 | 3,232 |
| Total liabilities and stockholders' equity | $ 5,545 | $ 5,407 |

*See accompanying notes to consolidated financial statements.*

**PARAGON TECHNOLOGIES, INC.**
Consolidated Statements of Operations (Unaudited)
For the Three and Six Months Ended June 30, 2014 and 2013
*(In Thousands, Except Share and Per Share Data)*

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2014 | June 30, 2013 | June 30, 2014 | June 30, 2013 |
| Net sales | $ 1,623 | $ 3,208 | $ 3,863 | $ 6,480 |
| Cost of sales | 1,226 | 2,218 | 2,827 | 4,563 |
| Gross profit on sales | 397 | 990 | 1,036 | 1,917 |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 568 | 666 | 1,116 | 1,249 |
| Product development costs | 8 | 2 | 28 | 15 |
| Total operating expenses | 576 | 668 | 1,144 | 1,264 |
| Operating income (loss) | (179) | 322 | (108) | 653 |
| Other income (expense): | | | | |
| Interest income | 3 | - | 4 | 21 |
| Interest expense | - | - | (1) | - |
| Other expense, net | 19 | (27) | 18 | (30) |
| Total other income (expense), net | 22 | (27) | 21 | (9) |
| Income (loss) before income taxes | (157) | 295 | (87) | 644 |
| Income tax expense | 6 | 166 | 12 | 117 |
| Net income (loss) | $ (163) | $ 129 | $ (99) | $ 527 |
| Basic earnings (loss) per share | $ (0.10) | $ 0.08 | $ (0.06) | $ 0.32 |
| Diluted earnings (loss) per share | $ (0.10) | $ 0.07 | $ (0.06) | $ 0.28 |
| Weighted average shares outstanding | 1,605,672 | 1,662,104 | 1,605,672 | 1,662,104 |
| Dilutive effect of stock options | 144,000 | 189,000 | 144,000 | 189,000 |
| Weighted average shares outstanding assuming dilution | 1,749,672 | 1,851,104 | 1,749,672 | 1,851,104 |

*See accompanying notes to consolidated financial statements.*

**PARAGON TECHNOLOGIES, INC.**
Consolidated Statements of Comprehensive Income (Loss) (Unaudited)
For the Three and Six Months Ended June 30, 2014 and 2013
*(In Thousands)*

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2014 | June 30, 2013 | June 30, 2014 | June 30, 2013 |
| Net income (loss) | $ (163) | $ 129 | $ (99) | $ 527 |
| Other comprehensive Income/loss: Unrealized gain/(loss) on marketable securities net of tax of ($24) for the six months ended June 30, 2014 and ($0) for the three months ended June 30, 2014 | 5 | (527) | 35 | (291) |
| Comprehensive income (loss) | $ (158) | $ (398) | $ (64) | $ 236 |

*See accompanying notes to consolidated financial statements.*

**PARAGON TECHNOLOGIES, INC.**
Consolidated Statements of Stockholders' Equity (Unaudited)
For the Twelve Months Ended December 31, 2013 and Six Months Ended June 30, 2014
*(In Thousands)*

| | Common Stock | | Additional Paid-In Capital | Retained Earnings / (Accumulated deficit) | Unamortized Restricted Stock | Accumulated Other Comprehensive Income | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | | | | | |
| Balance at December 31, 2012 | 1,656,854 | $ 1,657 | $ 3,441 | $ (193) | $ 5 | $ 12 | $ 4,922 |
| Net loss | - | - | - | (1,776) | - | - | (1,776) |
| Net change in unrealized gain on marketable securities, net of tax | - | - | - | - | - | 6 | 6 |
| Issue of common stock in lieu of directors' fees under directors' stock plan | 21,268 | 21 | 34 | - | - | - | 55 |
| Restricted stock grant to employee | 6,623 | 7 | 10 | - | (5) | - | 12 |
| Stock option grants to officers | - | - | 13 | - | - | - | 13 |
| Sale of common stock for cash | - | - | - | - | - | - | - |
| Balance at December 31, 2013 | 1,684,745 | 1,685 | 3,498 | (1,969) | - | 18 | 3,232 |
| Net income/(loss) | - | - | - | (99) | - | - | (99) |
| Net change in unrealized gain on marketable securities, net of tax | - | - | - | - | - | 35 | 35 |
| Stock option grants to officers and employee | - | - | 6 | - | - | - | 6 |
| Balance at June 30, 2014 | 1,684,745 | $ 1,685 | $ 3,504 | $ (2,068) | $ - | $ 53 | $ 3,174 |

*See accompanying notes to consolidated financial statements.*

**PARAGON TECHNOLOGIES, INC.**
Consolidated Statements of Cash Flows (Unaudited)
For the Six Months Ended June 30, 2014 and 2013
*(In Thousands)*

| | Six Months Ended June 30, 2014 | Six Months Ended June 30, 2013 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income (loss) | $ (99) | $ 527 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation of machinery and equipment | 16 | 18 |
| Amortization of intangible assets | 47 | |
| Realized gains on investments | (18) | 4 |
| Issue of common stock in lieu of directors' fees | - | 30 |
| Stock-based compensation | 6 | 5 |
| Deferred taxes | - | (64) |
| Change in operating assets and liabilities: | | |
| Receivables | (273) | (1,016) |
| Costs and estimated earnings in excess of billings | (51) | (24) |
| Inventories | (239) | (150) |
| Prepaid expenses and other current assets | 13 | (55) |
| Accounts payable | 417 | 1,209 |
| Billings in excess of costs and estimated earnings | 126 | (2) |
| Accrued salaries, wages, and commissions | (255) | 25 |
| Income taxes payable | (23) | |
| Accrued product warranties | (16) | (13) |
| Unearned support contract revenue | (79) | (62) |
| Accrued other liabilities and other adjustments | (198) | 197 |
| Net cash provided by (used in) operating activities | (626) | 629 |
| Cash flows from investing activities: | | |
| Purchases of investments | (191) | (1,890) |
| Purchases of machinery and equipment | (226) | (1) |
| Proceeds from sale of investments | 100 | 341 |
| Acquisition costs | - | (237) |
| Net cash used in investing activities | (317) | (1,787) |
| Cash flows from financing activities: | | |
| Bank loan – line of credit | 200 | - |
| Net cash from financing activities | 200 | - |
| Increase/(decrease) in cash and cash equivalents | (743) | (1,158) |
| Cash and cash equivalents, beginning of year | 2,546 | 4,504 |
| Cash and cash equivalents, end of period | $ 1,803 | $ 3,346 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for: | | |
| Interest expense | $ 1 | $ - |
| Income taxes | $ 27 | $ - |
| Supplemental disclosures of noncash investing activities: | | |
| Mark to market on available for sale securities, gross | $ 59 | $ (168) |

*See accompanying notes to consolidated financial statements.*

## (1) Description of Business and Summary of Significant Accounting Policies

### Description of Business and Concentration of Credit Risk

Paragon Technologies, Inc. ("Paragon" or the "Company"), based out of Easton, Pennsylvania, provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications through its wholly owned subsidiary, SI Systems, LLC ("SI Systems"). SI Systems' capabilities include horizontal transportation, rapid dispensing, order fulfillment, Systems Warehouse Execution Systems (WES), Warehouse Management Systems (WMS), Warehouse Control Systems (WCS), and aftermarket services.

SI Systems' automated material handling systems are used by manufacturing, assembly, order fulfillment, and distribution operations customers located primarily in North America. SI Systems' branded products are utilized to automate the movement or selection of products and are often integrated with other automated equipment such as conveyors and robots. SI Systems is brought to market as two individual brands, SI Systems' Order Fulfillment Systems (hereafter referred to as "SI Systems OFS") and SI Systems' Production & Assembly Systems (hereafter referred to as "SI Systems PAS").

The OFS business focuses on providing order fulfillment systems to distribution operations, including DISPEN-SI-MATIC®, Mobile-matic® (a patented product) and Warehouse Management Systems and Warehouse Control Systems software solutions with our VWare™ WES product. These systems are sold primarily through a nationwide network of authorized material handling integrators, dealers and direct to major OEM accounts.

The PAS business focuses on providing automated material handling systems to manufacturing and assembly operations via LO-TOW® horizontal transportation technologies. These systems are sold primarily to end users.

SI Systems' automated material handling systems are marketed, designed, sold, installed, and serviced by its own staff or subcontractors as labor-saving devices to improve productivity, quality, and reduce costs. SI Systems' integrated material handling solutions involve both standard and specially designed components and include integration of non-proprietary automated handling technologies to provide turnkey solutions for its customers' unique material handling needs. SI Systems' engineering staff develops and designs computer control programs required for the efficient operation of the systems and for optimizing manufacturing, assembly, and fulfillment operations.

Paragon also invests in businesses and securities under the Investment Management Policy. The Investment Management Policy sets forth the parameters under which a portion of Paragon's cash balance may be invested in marketable securities, including U.S. Treasuries, equities of publicly traded companies, bonds, money market instruments and other securities. Investment decisions under the Investment Management Policy are made by Sham Gad, Chairman of the Board. The Investment Management Policy sets forth restrictions on the investment of Paragon's funds, including an aggregate limit on Paragon's cash balance that is made available for investment, limits on the amount that may be invested in any single equity or fixed income position or certain categories of securities, prohibition of short-selling, margin trading and the use of leverage without Board approval, requirements for the management of the investment account, and other Board-approval requirements.

For the three months ended June 30, 2014, four customers individually accounted for sales of 26.7%, 20.9%, and 13.3% and 11.4%. For the three months ended June 30, 2013, three customers individually accounted for sales of 35.4%, 14.6% and 7.1%. No other customers accounted for over 10% of sales.

For the three months ended June 30, 2014, four customers individually owed the Company 26.5%, 18.5%, 18.5% and 12.6% of its trade receivables. Two of these customers were included in the 2013 sales concentration noted above. For the three months ended June 30, 2014, three customers individually owed the Company 62.2%, 15.9% and 8.1% of its trade receivables. No other customers owed SI Systems in excess of 10% of trade receivables at June 30, 2014 and 2013. The company believes that the concentration of credit risk in its trade receivables is substantially mitigated

## (1) Description of Business and Summary of Significant Accounting Policies *(Continued)*

### Description of Business and Concentration of Credit Risk *(Continued)*

by SI Systems' ongoing credit evaluation process as well as the general creditworthiness of its customer base.

SI Systems' business is largely dependent upon a limited number of large contracts with a limited number of customers. This dependence can cause unexpected fluctuations in sales volume. Various external factors affect the customers' decision-making process on expanding or upgrading their current production or distribution sites. The customers' timing and placement of new orders is often affected by factors such as the current economy, current interest rates, and future expectations. SI Systems believes that its business is not subject to seasonality, although the rate of new orders can vary substantially from month to month. Since SI Systems recognizes sales on a percentage of completion basis for its systems contracts, fluctuations in SI Systems' sales and earnings occur with increases or decreases in major installations. SI Systems maintains its cash and cash equivalents in financial institutions located in the United States of America. At times, cash balances may be in excess of F.D.I.C. limits. The Company's investment balances are held in broker accounts and may be in excess of S.I.P.C. limits.

### Principles of Consolidation

The consolidated financial statements include the accounts of Paragon Technologies, Inc., SI Systems, LLC., a wholly owned subsidiary, and Innovative Automation, Inc., a wholly owned subsidiary of SI Systems, LLC., after elimination of intercompany balances and transactions.

### Use of Estimates

The preparation of the financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The judgments made in assessing the appropriateness of the estimates and assumptions utilized by management in the preparation of the financial statements are based on historical and empirical data and other factors germane to the nature of the risk being analyzed. Materially different results may occur if different assumptions or conditions were to prevail. Estimates and assumptions are mainly utilized to establish the appropriateness of the inventory reserve, warranty reserve, deferred tax valuation allowance and revenue recognition on fixed price contracts.

### Innovative Automation, Inc.

On April 18, 2013 the company acquired Innovative Automation, Inc. (IA), a San Diego based company. The Company purchased all the outstanding capital stock with cash and a note payable due to seller as detailed herein. IA designs, builds and supports warehouse control systems software and has been in business since 1993.

The results of operations for IA have been included in the accompanying consolidated financial statements from the acquisition date forward. Revenue and costs since April 18, 2013 are not significant and therefore not reported separately. The purchase price was $562,500 consisting of cash payments of $150,000 a note payable of $350,000 and payment of certain liabilities of $62,500.

As part of the purchase agreement the seller may receive earn-out payments during the five year period following the closing date which will be accounted for as compensation in the period incurred. The earn-out payments are calculated based upon net booking of all warehouse control and management software related to the market segments that were served by the Synthesis division of the Company at the time of the acquisition. A portion of the earn-out is based upon a percentage of the revenue and the other portion is based upon certain gross margins achieved on the sales, as defined in the agreement. During the year ended December 31, 2013 and for the six months ended June 30, 2014 the seller earned approximately $19,000 and $28,000, respectively, which was recorded in accrued other liabilities on the consolidated balance sheet included in cost of sales on the consolidated statement of operations.

## (1) Description of Business and Summary of Significant Accounting Policies *(Continued)*

**Innovative Automation, Inc.** *(Continued)*

The provisional allocation of the purchase price to the assets acquired and liabilities assumed is based upon the estimated fair values at the date of acquisition. Any subsequent adjustments to these preliminary valuations will be detailed in the fiscal year 2014 financial statements and adjusted retroactively. The fair values of the assets and liabilities in the table below are based on preliminary independent valuations of assets acquired and liabilities assumed.

The following table summarizes the preliminary estimates of fair value of the assets acquired and the liabilities assumed as of the acquisition date, pending the final measurement of the intangible assets *(in thousands)*:

| | | |
|---|---|---|
| Trade accounts receivable | $ | 86 |
| Intangible asset - VWare™ software | | 761 |
| Intangible asset - Trade name | | 160 |
| Total assets acquired | | 1,007 |
| Accounts payable | | 46 |
| Deferred revenue | | 40 |
| Deferred tax liability | | 359 |
| Total liabilities assumed | | 445 |
| Fair value of net assets acquired | $ | 562 |

All acquisition-related costs, including legal, professional and other expenses, were expensed by the Company in the period incurred and not included in the purchase price. Acquisition costs were approximately $37,000 and are included in selling, general, and administrative expenses on the statement of operations for the year ended December 31, 2013.

**Cash and Cash Equivalents**

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, cash on deposit, amounts invested on an overnight basis with a bank or broker/dealer and other highly liquid investments purchased with an original maturity of three months or less.

**Trade Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable are stated at outstanding balances, less an allowance for doubtful accounts. The Company provides an allowance for doubtful accounts determined by a specific identification of individual accounts. The Company writes off receivables upon determination that no further collections are probable. There was no allowance for doubtful accounts as of June 30, 2014.

**Inventories**

Inventories are valued at the lower of average cost or market. Inventories primarily consist of materials purchased or manufactured for stock.

**Marketable Securities**

The Company's marketable securities portfolio is designated as available-for-sale. Securities classified as available-for-sale are those securities that the Company intends to hold for an indefinite period of time but not necessarily to maturity. Securities available-for-sale are carried at fair value. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Company's assets and liabilities, liquidity needs, capital considerations and other similar factors. Unrealized gains and losses are reported as increases or decreases in other comprehensive income (loss). Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings.

## (1) Description of Business and Summary of Significant Accounting Policies *(Continued)*

**Marketable Securities** *(Continued)*

Declines in the fair value of securities below their cost that are deemed to be other-than-temporary impairments (OTTI) are reflected in earnings as realized losses. In estimating OTTI under the rules for accounting for certain debt and equity securities, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than amortized cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to anticipated recovery, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

The Company has not recognized any other-than-temporary impairment losses for the six months ended June 30, 2014.

The amortized cost and approximate fair value of marketable securities available-for-sale as of June 30, 2014 are summarized as follows *(in thousands)*:

| | Equity Securities | | | |
|---|---|---|---|---|
| | Amortized Costs | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| June 30, 2014 ............................... | $ 405 | $ 96 | $ 8 | $ 493 |
| December 31,2014 ……………….. | $ 295 | $ 44 | $ 14 | $ 325 |
| June 30, 2013 .............................. | $2,617 | $108 | $276 | $2,449 |

At June 30, 2014, the Company had one equity security in an unrealized loss position for less than one month and one equity security in an unrealized loss position for less than three months. The decline in fair value is not due to credit losses. The Company does not intend to sell these securities prior to recovery and it is more likely than not that the Company will not be required to sell these securities prior to recovery and, therefore, no securities are deemed to be other-than-temporarily impaired. Fair value accounting guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions. In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

## (1) Description of Business and Summary of Significant Accounting Policies *(Continued)*

**Marketable Securities** *(Continued)*

*Level 1* — Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

*Level 2* — Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

*Level 3* — Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2014 are as follows *(in thousands)*:

| | Equity Securities | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| As of June 30, 2014.................... | 493 | 493 | | |
| As of December 31, 2013……….. | 325 | 256 | 69 | |
| As of June 30, 2013.................... | $2,449 | $2,449 | - | - |

**Equity Method Investment**

As of June 30, 2014 and December 31, 2013, the Company had 1,430,860 shares in SED International Holdings, Inc. (SED), representing 27.7% of the outstanding share capital of SED. At December 31, 2012, SED was traded on the NYSE, and the Company accounted for its shares in SED as a marketable equity security. Effective on or about November 26, 2013, SED voluntarily delisted its common stock from the NYSE and began trading on the OTC markets under ticker symbol SEDN, which is not considered an active market as defined by ASC 320, Investments – Debt and Equity Securities. As a result, the Company adopted the equity method of accounting for its investment in SED. Under this method, the Company's equity in the earnings or losses of the investee is reported currently in the Company's earnings. Upon adoption, the investment, results of operations, and retained earnings were adjusted retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods in which the Investment was held. SED's last available published financial statement is for period ending June 30, 2013. No further quarterly reports are publicly available. The latest closing price of SED as reported by the OTC Markets is $0.153 as of August 7, 2014.

## (1) Description of Business and Summary of Significant Accounting Policies *(Continued)*

**Equity Method Investment** *(Continued)*

The following is the investment activity for SED for the year ended December 31, 2013 and six months ended June 30, 2014 *(in thousands)*:

| | June 30, 2014 | December 31, 2013 |
|---|---|---|
| Opening balance as of January 1, ………………… | $ - | $ 597 |
| Equity method investment ………………………… | - | 2,400 |
| Loses in investment based on equity method……. | - | (2,997) |
| Closing balance as of ……………………………… | $ - | $ - |

**Fixed Assets**

Machinery and equipment are recorded at cost and are depreciated on the straight-line method over the estimated useful lives of individual assets. The ranges of lives used in determining depreciation rates for machinery and equipment is generally 3 - 7 years. Maintenance and repairs are charged to operations; betterments and renewals are capitalized. Upon sale or retirement of machinery and equipment, the cost and related accumulated depreciation are removed from the accounts and the resultant gain or loss, if any, is credited or charged to earnings.

**Intangible Assets Impairment**

The Company reviews the recovery of the net book value of long-lived assets whenever events and circumstances indicate that the net book value of an asset may not be recoverable. In cases where undiscounted expected future cash flows are less than the net book value, an impairment loss is recognized equal to an amount by which the net book value exceeds the fair value of assets.

**Revenue and Cost Recognition**

Revenues on fixed price systems contracts are recorded on the basis of the Company's estimates of the percentage of completion of individual contracts. Revenue and gross profit is recognized on the basis of the ratio of aggregate costs incurred to date to the most recent estimate of total costs. As contracts may extend over one or more years, revisions in cost and profit estimates during the course of the work are reflected in the accounting periods in which the facts requiring revisions become known. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is accrued.

Contract costs include all direct material, subcontract and labor costs, and those indirect costs related to contract performance, including but not limited to costs such as indirect labor, supplies, tools, repairs, and depreciation. Selling, general and administrative costs are charged to expense as incurred. Changes in job performance, job conditions, and estimated profitability may result in revisions to costs and income, which are recognized in the period in which the revisions are determined.

The asset, “Costs and estimated earnings in excess of billings,” represents revenues recognized in excess of amounts billed on uncompleted contracts. The liability, “Billings in excess of costs and estimated earnings,” represents billings in excess of revenues recognized on uncompleted contracts.

Revenues on other sales of parts or equipment are recognized when title transfers pursuant to shipping terms. There are no installation or customer acceptance aspects of these sales.

Revenue on individual support contracts is recognized on a straight-line basis over the one-year term of each individual support contract.

## (1) Description of Business and Summary of Significant Accounting Policies *(Continued)*

**Unearned Support Contract Revenue**

The Company offers its Order Fulfillment customers one-year support contracts for an annual service fee. The support contracts cover a customer’s single distribution center or warehouse where the

Company's products are installed. As part of its support contracts, the Company provides analysis, consultation, and technical information to the customer's personnel on matters relating to the operation of its Order Fulfillment System and related equipment and/or peripherals.

The Company records advance payments for unearned support contracts in the balance sheet as a current liability that are in excess over amounts recognized as revenue at the end of each period. Revenue on individual support contracts is deferred and recognized on a straight-line basis over the one-year term of each individual support contract.

**Product Development Costs**

The Company expenses product development costs as incurred, on products that have been placed in service.

**Software Development Costs**

The Company capitalizes costs incurred to develop commercial software products or enhancements to software products where such enhancements extend the life of the products. During the period May 2013 to March 2014 the Company carried out a major enhancement to VWARE™ and capitalized the following costs:

| Period *(amount in thousands)* | Amount capitalized |
|---|---|
| May to December 2013 | $ 217 |
| January to June 2014 | $ 111 |
| Total capitalized as of June 2014 | $ 328 |

Annual amortization expense is calculated based on straight-line method over the economic life of the software as determined by the Company in this instance as five years from July 1, 2014. The expected amortizations in the future are $32 in 2014, $66 in 2015, $66 in 2016, $66 in 2017, $66 in 2018 and $32 in 2019.

**Accrued Product Warranty**

The Company's products are warranted against defects in materials and workmanship for varying periods of time depending on customer requirements and the type of system sold, with a typical warranty period of one year. The Company provides an accrual for estimated future warranty costs and potential product liability claims based upon a percentage of cost of sales, typically one and one-half percent of the cost of the system being sold. A detailed review of the liability needed for products still in the warranty period is performed each quarter.

A roll-forward of warranty activities is as follows *(in thousands)*:

| | Beginning Balance January 1 | Additions (Reductions) Included in Cost of Sales | Claims | Ending Balance June 30 |
|---|---|---|---|---|
| 2014 | $ 159 | $ (16) | $ - | $ 143 |
| 2013 | $ 132 | $ (12) | $ (25) | $ 119 |

**Income Taxes**

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Income tax expense is the tax payable or refundable for the period, plus or minus the change during the period in deferred tax assets and liabilities.

Tax benefits for uncertain tax positions are recognized when it is more likely than not that the position will be sustained upon examination based on its technical merits. The Company classifies interest and penalties related to unrecognized tax benefits as a component of income tax expense. To the extent interest and penalties are not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision.

**Stock-Based Compensation**

The Company has a shared-based compensation plan in place and records the associated stock-based compensation expense over the requisite service period. These share-based compensation plans and related compensation expense are discussed more fully in Note 4 to the consolidated financial statements.

Restricted stock awards that are service-based are recorded as deferred compensation and amortized into compensation expense on a straight-line basis over the vesting period, which ranges from three to four years in duration. Compensation cost for service-based restricted stock is based on the grant date fair value of the award, which is the closing market price of the Company's common stock on the grant date multiplied by the number of shares awarded.

**Earnings Per Share**

Basic and diluted earnings per share for the six months and three months ended June 30, 2014 and 2013 are based on the weighted average number of shares outstanding. In addition, diluted earnings per share reflect the effect of dilutive securities which include the shares that would be outstanding assuming the exercise of dilutive stock incentive plan awards. The number of shares that would be issued from the exercise has been reduced by the number of shares that could have been purchased from the proceeds at the average market price of the Company's common stock.

## (2) Line of Credit

On February 19, 2009, the Company established a $5,000,000 line of credit facility with its principal bank to be used primarily for working capital purposes. The line of credit facility contained various non-financial covenants and was secured by all of the Company's accounts receivables and inventory. The availability on the line of credit was $3,300,000 as of December 31, 2012. Interest on the line of credit facility was at the LIBOR Market Index Rate plus 1.25%. The leasing agreement associated with the Company's principal office was secured with a $200,000 letter of credit at December 31, 2012 under the line of credit facility. There were no borrowings outstanding, and the line of credit expired, as of November 30, 2012. The Company's outstanding Letter of Credit expired in February 2013.

On May 30, 2013, the Company established a $750,000 line of credit facility with its principal bank to be used primarily for working capital purposes. The line of credit facility contains various non-financial covenants and is secured by all of the Company's accounts receivables and inventory. The availability on the line of credit was $750,000 as of September 30, 2013. Interest on the line of credit facility is based on the "Wall Street Journal Prime." There were $200,000 of borrowings outstanding as of June 30, 2014.

## (3) Intangible Assets

Intangible assets are as follows:

| | Gross Carrying Amount | Accumulated Amortization | Net Book Value |
|---|---|---|---|
| VWARE™ software ........................ | $ 764 | $ - | $ 764 |
| Trade name .................................... | 160 | 88 | 72 |
| | $ 924 | $ 88 | $ 836 |

Aggregate amortization expense for intangible assets is estimated to be as follows: 2015 $104; 2016 $154; 2017 $175; 2018 $195; and 2019 $208.

## (4) Stock Options and Non-vested Stock

**2012 Equity Incentive Plan**

On July 27, 2012, the Board of Directors of the Company adopted the Paragon Technologies, Inc. 2012 Equity Incentive Plan (the “Plan”). Under the Plan, the Board may grant restricted stock, stock options, stock appreciation rights and other equity-based awards to employees, directors and consultants of the Company. Initially, there were 200,000 shares of the Company’s common stock available for grant under the Plan. The Plan provides that it will be administered by the Board or a committee of the Board that may be designated in the future. The Plan has a term of 10 years. On September 18, 2013, the Board of Directors increased the number of shares of common stock available for grant under the Plan to 350,000 shares.

Under the Plan, officers have been granted options to purchase shares of common stock. Each of these options has an exercise price equal to the average of the closing bid and asked prices for the Company’s common stock on the OTC Markets for the thirty trading days immediately preceding the grant date. Stock options vest in four or five equal annual installments beginning on the first anniversary of the date of grant. Vested stock option awards may be exercised through payment of cash, exchange of mature shares, or through a broker. As of June 30, 2014, 144,000 stock options are outstanding under the plan, and all stock options have a term of ten years. The exercise prices of the stock options outstanding under the plan range from $2.48 to 2.88.

Stock-based compensation expense recognized during the six months ended June 30, 2014 for stock-based compensation programs was $6,000. Stock-based compensation expense recognized during the six months ended June 30, 2013 consisted of expensing $44,370 for employee stock options, and $5,000 for non-vested stock. All of the stock-based compensation expense recognized was a component of selling, general and administrative expenses.

As of June 30, 2014, all of the officers that had been granted options to purchase shares of common stock had terminated their employment. Per the stock option award agreement the term of the options shall expire (1) month after the termination of Optionee’s employment with the company for any reason (the “Expiration Date”). Upon the Expiration Date, the Option will automatically be cancelled and will be of no further force or effect to the extent not exercised prior thereto.

As of June 30, 2014 one option for 45,000 shares was cancelled. The remaining options for 144,000 shares have been cancelled during July 2014.

### Directors’ Fees Paid

Effective July 2012, directors are entitled to the following director compensation:

- Annual retainer of $20,000 per year, paid quarterly, with the first two quarters paid in cash and the last two quarters paid in equity, per the Director’s Equity Plan;
- Fee of $2,500 per director for each in-person Board Meeting;
- The Company will pay travel and hotel lodging for in-person Board Meetings;
- Fee of $500 per director for each Board Teleconference Meeting;
- Fee of $1,000 for the Chair of the Audit Committee for each committee meeting; and
- Fee of $500 per director for each committee meeting.

Effective July 2013, directors are entitled to the following director compensation:

- Annual retainer of $40,000 per year:
- $30,000 in cash payable quarterly; and
- $10,000 in shares of common stock under the Equity Incentive Plan.
- The company will pay travel and hotel lodging for in person Board Meetings;

For years ended December 31, 2012 and 2012, the company issued 3,936 and 7,544 shares, respectively, to the directors under this Plan, with an expense of $10,000 and $20,000 respectively.

For 2014, each director, including Mr. Gad, will be paid $30,000 in cash in four equal quarterly installments in advance. The Company will continue to pay travel and hotel lodging for in-person board meetings.

**Chairman's Compensation**

Effective September 2012, in recognition of Mr. Gad's efforts and responsibilities to the Company in his role as Chairman including directing the Company's capital allocation program, the independent directors of the Board established Mr. Gad's annual compensation as an annual retainer of $110,000 per year paid $50,000 in cash and $60,000 in shares of common stock, paid quarterly, with the common stock being valued based on the average of the closing bid and asked prices for the Company's common stock on the OTC Markets for the 30 trading days immediately preceding stock issuance. This compensation will be paid to Mr. Gad in lieu of all other Board compensation and meeting fees. The compensation was determined by the Company's independent directors, in consultation with the Company's outside counsel, and will be reviewed annually.

Effective July 2013, the payment of Mr. Gad's compensation was revised to be paid $80,000 in cash and $30,000 in shares of common stock.

For the year ended December 31, 2013 and 2012, the Company issued 17,332 and 14,000 shares, respectively, to the Chairman under this Plan, with an expense of $45,000 and $35,000, respectively.

As noted previously, for 2014, Mr. Gad will be paid $30,000 in cash in four equal quarterly installments in advance.

**Employee Equity Grants**

On August 28, 2012, in connection with the commencement of his employment as the Company's Chief Executive Officer and President, Mr. Strayhorn was granted an option to purchase 104,000 shares of the Company's common stock under the Plan. The option will vest, subject to Mr. Strayhorn's continued employment with the Company through the applicable vesting date, over a period of five years, commencing on December 31, 2013.

On August 30, 2012, in connection with the commencement of his employment as the Company's Chief Financial Officer, Mr. Cherian was granted an option to purchase 45,000 shares of the Company's common stock. The option will vest, subject to Mr. Cherian's continued employment with the Company through the applicable vesting date, over a period of four years commencing on December 31, 2013.

Each of these options has an exercise price equal to the average of the closing bid and asked prices for the Company's common stock on the OTC Markets for the thirty trading days immediately preceding the grant date. The term of each of these options is ten years from the date of grant. In the event of a change in control of the Company, the vesting of each of these options will be accelerated. The Company issued 3,000 shares of the Company's common stock under the Plan to Mr. Peter Rice, Vice President of Sales and Marketing, on February 1, 2013.

On April 22, 2013, in connection with the commencement of his employment as the Vice-President Software and Technology, Mr. Kevin Tedford was granted an option to purchase 40,000 shares of the Company's common stock. The option will vest, subject to Mr. Tedford's continued employment with the Company through the applicable vesting date, over a period of four years commencing on April 22, 2014.

On October 1, 2013, in connection with his conversion to full-time employment as the Chief Operating Officer and Chief Financial Officer, Mr. Jacob Cherian was granted 3,623 shares of the Company's restricted common stock under the Plan.

As noted previously, all of the above officers who received options to purchase shares of stock have terminated their employment as of June 30, 2014 and all options have expired during June and July of 2014.

## (5) Employee Benefit Plans

The Company has a defined contribution Retirement Savings Plan for its employees. Employees age 21 and above are eligible to participate in the Plan. Effective March 30, 2009, Company contributions under the Company's Retirement Savings Plan have been suspended for an indefinite period of time as part of a cost-reduction initiative. The Plan also contains provisions for profit sharing contributions in the form of cash as determined annually by the Company's Board of Directors. There was a profit sharing contribution of $30,000 for the six months ended June 30, 2014 and there was no profit sharing contribution for 2013. Total expense for the Retirement Savings Plan, including plan expenses, was $300 for the six months ended June 30, 2014. There was $800 of expense for the six months ended June 30, 2013.

## (6) Income Taxes

The provision for income tax expense (benefit) consists of the following *(in thousands)*:

| | | For the Six Months Ended June 30, 2014 | For the Six Months Ended June 30, 2013 |
|---|---|---|---|
| Federal: | current | $ - | $ - |
| | deferred | - | (51) |
| | | - | (51) |
| State: | current | 11 | 18 |
| | deferred | - | (16) |
| | | 11 | 2 |
| | | $ 11 | $ (49) |

The Company has federal net operating losses of approximately $132,000 at December 31, 2013, expiring at various times through December 31, 2032. The Company has state net operating losses of approximately $169,000 at December 31, 2013, expiring at various times based on individual state limits.

Valuation allowances are provided to reduce the carrying amount of deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized. When assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in the appropriate taxing jurisdictions during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, taxable income in carryback years, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income, management has concluded that the Company's deferred tax assets are more likely than not to expire before the Company can use them and, therefore, the Company's management has concluded that a full valuation allowance for deferred tax assets, net of deferred tax liabilities, was appropriate as of December 31, 2013 and 2012.

The Company is subject to U.S. federal income tax as well as income tax of multiple state jurisdictions.

## (7) Contingencies

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. Although the amount of any liability that could arise with respect to currently pending actions cannot be accurately predicted, in the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations, or liquidity.

## (8) Commitments

The Company leased 25,000 square feet in Easton, Pennsylvania for use as its principal office. The leasing agreement required fixed monthly rental payments of $18,000. The terms of the lease also required the payment of a proportionate share of the facility’s operating expenses. The leasing agreement was secured with a $200,000 letter of credit. The lease expired on February 20, 2013.

On November 28, 2012, the Company renewed the lease agreement to extend the term of the lease for a period of one year. Commencing on February 21, 2013, the square footage of the lease was reduced to 15,200 square feet. The renewed lease agreement required fixed monthly rental payments of $12,750 for one year through February 20, 2014. The terms of the lease no longer required the payment of a proportionate share of the facility’s operating expenses.

On December 30, 2013, the Company entered into a new lease agreement for an initial term of two years followed by an option to renew for two consecutive/additional terms of two years each. The lease commenced on April 15, 2014 and expires on February 14, 2016 if Company does not renew the lease. The area of the new lease is 9,648 square feet in Easton, Pennsylvania. The leasing agreement requires fixed monthly payments of $12,750.

Total rental expense for the six months ending June 30, 2014 and 2013 approximated $58,000, and $87,000, respectively.

Future minimum rental commitments at June 30, 2014 are as follows *(in thousands):*

| | Operating Leases |
|---|---|
| 2014 | $ 76 |
| 2015 | 153 |
| 2016 | 64 |
| TOTAL .................... | $ 293 |

## (9) Stock Repurchase Program

On August 12, 2004, the Company’s Board of Directors approved a program to repurchase up to $1,000,000 of its outstanding common stock. The Company’s Board of Directors amended its existing stock repurchase program on several occasions during 2005, 2006, 2007, and 2008 by increasing the amount it authorized management to repurchase from up to $1,000,000 of the Company’s common stock to up to $22,000,000.

From the inception of the Company’s stock repurchase program on August 12, 2004 through December 31, 2012, the Company repurchased 2,850,100 shares of common stock at a weighted average cost, including brokerage commissions, of $6.75 per share. Cash expenditures for the stock repurchases since the inception of the program were $19,239,194. As of May 10, 2013, $2,760,806 remained available for repurchases under the stock repurchase program.

On May 10, 2013, the Company's Board of Directors approved cancellation of the stock repurchase program.

**(10) Subsequent Events**

Events and transactions for items that should potentially be recognized or disclosed in these financial statements occurring subsequent to the balance sheet date of March 31, 2014 have been evaluated through August 14, 2014, the date which these financial statements were available to be issued.